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RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
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RUEHSA/AMEMBASSY PRETORIA 5947
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USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
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E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD EMIN ENRG BEXP KTDB SF
SUBJECT: SOUTH AFRICA'S 2008 BUDGET

¶1. (U) Summary. South Africa Minister of Finance Trevor Manuel delivered his annual Budget Speech before Parliament on February 20, ¶2008. According to Manuel, South Africa continues to have a positive fiscal outlook despite global economic turmoil. GDP growth was projected at 4 percent with the government posting a budget surplus of 1.0 percent of GDP for 2007/2008 and an estimated 0.8 percent in 2008/2009. Proposed spending plans support further economic growth and expanded social welfare including additional incentive funding for the industrial policy framework and increased social grants. Power utility Eskom will receive a R60 billion infusion of funds to assist with power generation projects. Manuel proposed tax relief for corporations while he revealed plans to impose a levy on revenue from electricity generated by non-renewable sources. In line with past gradual relaxation of exchange controls, Manuel announced that exchange controls on institutional investors will be removed and replaced with prudential regulation. End Summary.

POSITIVE FISCAL OUTLOOK

¶2. (U) Amid the backdrop of a turbulent global economy and strong inflationary pressures, Manuel stressed that South Africa's key macroeconomic policy anchors put in place since 1996 provide a "solid mooring" that will enable the economy to adapt to current conditions and allow the country to remain confident that it will weather the global storm. Manuel reported that once again South Africa attained a budget surplus; 1 percent of GDP for 2007/2008 and an estimated surplus of 0.8 percent in 2008/2009. Growth is projected at 4 percent this year. Government revenue is expected to be R580 billion in 2007/2008, 15.7 percent more than in 2006/2007. Government debt is projected to be 16 percent of GDP by 2011, from 33 percent three years ago. Investment in fixed capital expanded rapidly in 2007 with investment as a share of GDP rising from about 15 percent to 21 percent. Manuel noted, however, that the current account deficit makes the economy more vulnerable, especially during times of stress in global financial markets.

PUBLIC PRIORITIES AND SPENDING PLAN

¶3. (U) Manuel announced government spending plans for a progressive extension of public services for 2008/2009. Budget support for the industrial policy framework includes R2.3 billion for the Department of Trade and Industry over the next three years and tax incentives of R5 billion in support of industrial investment and employment

creation. Social grant increases this year match or exceed inflation, including an increase in disability and old age grants and child support grants. Total additional measures to expand the social security net amount to R12 million over the next three years, with total expenditure on social assistance equaling R75.3 billion in 2007/2008.

¶4. (U) Other categories for proposed expenditures for 2008/2009 include:

-- Allocations to provinces: R238 billion to provide improvements in education, health, welfare, and housing programs.

-- Health services: 10 percent growth over the next three years on expenditures for the hospital revitalization program, conditional grants for HIV/AIDS and additional resources for tuberculosis

-- Education and skills development: Additional allocations over the R105 billion spent in 2007/2008 are expected for both elementary and higher education programs.

-- Crime fighting: R10 billion over the next three years in increased spending.

-- Infrastructure investment: R17 billion will be added to the budgets of departments of housing, provincial and local government, water affairs, sport and recreation and transport over three years, mainly for infrastructure. Transportation parastatal Transnet will also invest in excess of R78 billion in transportation infrastructure, while Eskom's capital expansion plans, including power generation, will amount to R343 billion.

-- Peacekeeping and development: R1.3 billion over the next three years to support development and attainment of the Millennium

Development Goals on the continent.

ESKOM SUPPORT

¶5. (U) Manuel addressed the growing concern over Eskom's inability to finance its much-needed new power stations by proposing "that up to R60 billion should be provided to support Eskom's investment program, on terms structured to assist in meeting cash flow requirements." Manuel noted that this funding is not a grant, but that the return on investment in power generation is "very long term."

TAX PROPOSALS

¶6. (U) Manuel announced two major revisions among the tax proposals: the reduction of corporate tax rates from 29 percent to 28 percent and a new levy to be introduced this year on the sale of electricity generated from non-renewable sources, at a rate of 2 cents per kilowatt hour. Other tax reforms include proportional increases for inflation, such as personal income tax relief of R7.2 billion, measures to reduce the tax compliance burden on small businesses, and allowances to boost job creation.

CURRENCY EXCHANGE CONTROLS REMOVED

¶7. (U) In line with last year's continuation of the gradual process of relaxing exchange control, Manuel announced that exchange controls on institutional investors will be removed and replaced with prudential regulation involving quarterly reporting, and monitoring of foreign exposures by the Reserve Bank. In addition, the foreign exposure limits for institutional investors will be raised and banks will be permitted to undertake foreign investment within an appropriate macro-prudential limit. Participation in the rand futures market on the JSE Securities Exchange will also be

opened up.

COMMENT

¶8. Despite speculation that the recent change in ANC leadership might result in a loosening of fiscal policy, Manuel held his ground on the budget surplus as a prudent fiscal measure in an uncertain and turbulent economic environment. South Africa's strong macroeconomic policies have allowed government to increase annual spending while still building a budget surplus.

BOST